Treasury Trends

Bringing currency to the Arizona Taxpayer

David A. Petersen, State Treasurer

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This month's character trait ---

Alertness:

Being aware of that which is taking place around me so I can have the right responses

Both LGIP Pools continue to increase their yields in September 2004

Coming Soon!

New LGIP Pools:

-potentially higher income & total return

- longer duration

- diversification

LGIP Performance

The Board of Investment, in the regular meeting held on October 20, 2004, was informed of the performance of the LGIP and LGIP-Gov pools. Both pools continued to increase their yields over the previous month. Balances of the pools also remained relatively stable for the month.

Yields	LGIP	LGIP Index	Diff	LGIP-GOV	3 mo. T-Bill	Diff
Pool size →	**$2.4 B**			**$1.06 B**		
January '04	1.41	.85	+.56	.98	.89	+.09
Feb '04	1.44	.85	+.59	1.00	.93	+.07
March '04	1.39	.84	+.55	1.01	.95	+.06
April '04	1.39	.84	+.55	1.02	.95	+.07
May '04	1.39	.84	+.55	1.01	1.03	-.02
June '04	1.45	.88	+.57	1.06	1.26	-.20
July '04	1.59	1.03	+.56	1.25	1.34	-.09
August '04	1.72	1.20	+.52	1.39	1.49	-.10
September '04	1.81	1.34	+.47	1.45	1.67	-.15
October '03	1.43	.83	+.60	.97	.93	+.04
November '03	1.43	.85	+.58	.99	.94	+.05
December '03	1.44	.88	+.56	.98	.90	+.08

New Pools Introduced to LGIP Advisory Board

The LGIP Advisory Board members and LGIP participants were given an overview of the two new LGIP Pools at the Board Meeting held October 20, 2004 at the State Treasurer's Office. Minh Trang, the Treasury's LGIP outreach coordinator, shared the structure and objectives of the two new pools. It was emphasized these two new pools are specifically designed for core investment assets not needed for a minimum of one to two years. Participants in these pools: (1) are seeking to maximize income or total return, (2) have a long-term investment horizon, (3) need greater diversification, (4) can tolerate risk associated with market volatility, and (5) can invest in a floating NAV pool. Attendees seemed excited about the possibilities for these two new pools. ***If your investments include long-term core funds, call us about the new pools which will be available shortly. Summary pages are attached for your review.***

Nationwide Perspective

Flattening Yield Curve Affects Bond Mgt Techniques

Federal Reserve continues to raise short-term rates, causing a flattening of the curve

Usually, bond investors receive extra yield for extending the maturity on a bond. In simple terms, the longer the maturity, the higher the interest rate received. There are times however, when the increase in interest rates is not commensurate with the increase in maturity. There have been times, when the short-term interest rates are higher than the long-term interest rates. This is known as an "inverted yield curve." If you look at the treasury yield curve box listed below, it is apparent we are still in a normal yield curve situation. However, the current yield curve is flattening. For example, last year at this time, there was 4.2% difference between the 3-month treasury and the 30-year treasury. Now, there is only a 2.9% difference between the 3-month treasury and the 30-year treasury. What does this mean? Bond investors are receiving less and less premium for extending out their duration. In fact, with the Federal Reserve Board promising "measured increases" in the short-term interest rates, it is possible that someone buying a two or three-year treasury today, could find themselves earning less than the overnight yield in just a few short months. At that point, there are only two choices: hold the bond to maturity, while earning a below-market yield, or sell the bond at a loss and buy a new bond paying a higher yield. Either way, the total return could be less for the two-year investment than for short-term overnight investments. This is a highly uncertain time where the middle of the yield curve (3 to 10 years) could be the most dangerous to investors.

LGIP Increases Liquidity for Participants

LGIP Increases liquidity for participants

One of the main benefits of participating in the LGIP is increased liquidity. Some participants have expressed the idea that they would have more liquidity by owning securities directly. Unfortunately, the opposite may actually be true. Consider this scenario. A city has $50 million in treasury notes of various maturities. Due to an unforeseen circumstance, the city needs $30 million of those funds for the next day. In order to raise the cash, the city goes into "fire sale" mode. The bond market, smelling the desperation, comes in with vulture bids. Price received drops, total return plummets, and the city's taxpayers are saddled with the losses. The LGIP on the other hand, has constant cash flows in and out from multiple participants, including the general fund of the State of Arizona. In an emergency, it is possible for us to waive our notification requirements and send out the cash without liquidating positions. Your liquidity is increased, total return is maintained, and everyone benefits.

LGIP: local & state government working together to safeguard Arizona taxpayers' money.

Yield Curve Perspective

Treasury Yield Curve				
Term	**22 Oct**	**1 Week Earlier**	**1 Month Earlier**	**1 Year Earlier**
3 mo.	1.83	1.74	1.70	0.95
6 mo.	2.05	1.99	1.92	1.02
2 yr.	2.51	2.52	2.46	1.76
3 yr.	2.74	2.75	2.73	2.21
5 yr.	3.25	3.31	3.25	3.18
10 yr.	3.97	4.05	3.98	4.13
30 yr.	4.75	4.85	4.77	5.14

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